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Minnesota Supreme Court Holds That A Homestead Property Held In Joint Tenancy Cannot Be Unilaterally Severed By A Judgment Against One Spouse.

In Kipp v. Sweno, 683 N.W.2d 259 (Minn. 2004), the Minnesota Supreme Court held that judgment creditors could not unilaterally sever the joint tenancy of a homestead property in order to collect from one of the spouse's assets. In this case, the debtor was found liable to the creditors for failing to complete a construction project that he agreed to complete.

The original judgment was entered against the debtor for $168,633.00 in 1987. After accruing thirteen years of interest and having attorney's fees awarded to the creditors, the debtor owed the creditors approximately $300,000.00 by the year 2000. The creditors initiated a sheriff's execution sale of debtor's homestead. The debtor's homestead had an appraised value of $309,900.00. The debtor argued that his undivided one-half interest in the homestead did not exceed the $200,000.00 homestead exemption, and therefore could not be reached by the creditors. The District Court agreed with the debtor's argument finding that a judgment creditor cannot reach debtor's undivided one-half interest. On appeal, the Minnesota Court of Appeals reversed the District Court's legal conclusion that the debtor's portion of the joint tenancy could not be unilaterally severed by the debtor's creditors. After a remand to the District Court to order a foreclosure sale, the creditors were the successful high bidder at the sheriff's execution sale. The creditors made a credit bid of $300,306.84 for the debtor and the non-debtor spouse's homestead. After the numerous court proceedings at the District Court and Court of Appeals the questions of: (1) whether a judgment creditor could unilaterally sever a joint tenancy of homestead property held by a married couple; and (2) whether the $200,000.00 homestead exemption can be fully used by only one spouse finally reached the Minnesota Supreme Court.

As to the first question, the Minnesota Supreme Court recognized several statutory rights of the non-debtor spouse in reaching the decision that a joint tenancy could not be unilaterally severed by a judgment creditor. The Court would not allow a unilateral severance by judgment creditors because that would threaten the non-debtor spouse's possessory interest, right of survivorship, and remainder interest in the homestead property. See Minn. Stat. § 500.19, Subd. 5 (2002) (defining when severance of a joint tenancy would be effective); Minn. Stat. § 507.02 (2002) (statute precluding a joint-tenant spouse who unilaterally severs a joint tenancy from individually conveying such property); and Minn. Stat. § 507.02 (2002) (a surviving spouse retains his or her right of survivorship despite a joint tenancy being severed). The Court also recognized the strong public policy in Minnesota of preserving the homestead property. Moreover, the Court emphasized that a judgment creditor should not be allowed to acquire more property rights in a property than those already held by the judgment debtor.

It should be noted that pursuant to Minn. Stat. § 500.19, Subd. 5 (4) a joint tenancy can be "sever[d] [when it] is effected pursuant to bankruptcy of a joint tenant." It is an open question whether the same result would had been reach had the judgment debtor filed for bankruptcy protection.

Taconite Tax Not an "Interest" Extinguished by 363(f)

Ruling on a motion to enforce a sale order, the United States Bankruptcy Court, District of Minnesota, recently held that Minnesota's

taconite production tax scheme and its application by the Minnesota Department of Revenue did not create, recognize, or enforce an "interest" in property that was subject to 11 U.S.C. § 363(f). In re Eveleth Mines, LLC dba EVTAC Mining and Thunderbird Mining Co., Bky. Nos. 03-50569 and 03-50641 (Bankr.D.Minn. 2004). The Court also held that the terms of the asset sale order itself did not foreclose the Minnesota Department of Revenue from applying the statutory averaging formula.

Cleveland Cliffs, Inc., and Laiwu Steel Group, Ltd., formed United Taconite, LLC ("United Taconite"), in order to bid on the sale of Debtor. The Court approved the Debtor's sale of its operating assets to United Taconite and entered an order approving the sale on November 26, 2003 (the "Order"). In pertinent part, the Asset Purchase Agreement ("Agreement") states that United Taconite shall not assume or pay any of the Debtor's liabilities, including "any taconite production tax attributable to the mining and beneficiation of taconite ore into enriched iron ore pellets that has been or may be assessed by any Taxing authority, including but not limited to the Minnesota Department of Revenue…" The Order contained a similar provision to the one in the Agreement, quoted above, and explicitly stating that United Taconite was not to assume any taconite production tax assessed for any period pursuant to section 298.24-298.27 of the Minnesota Statutes. Furthermore, the Order stated that "Pursuant to §§ 105(a) and 363(f) of the Bankruptcy Code, the Debtor is authorized to transfer title to the Mining Assets to the Buyer free and clear of (a) all interests, pledges, liens…obligations for the payment of taconite production taxes related to the mining and production operations by [the] Debtor using the Mining Assets, on [sic] restrictions or charges of any kind or nature whatsoever…"

On February 13, 2004, the Minnesota Department of Revenue ("MDOR") issued a Notice of Taconite Production Tax to United Taconite. In that notice, MDOR used the statutory method for assessing taxes on taconite production, which imposes a statutory rate against the average production for the three prior years. The result was a net production tax liability of $7,006,378 (average production of 3,331,611 tons during 2001, 2002, and 2003 times the statutory rate of $2.103). MDOR then divided that liability between the Debtor and United Taconite based upon each company's fractional share of the facility's total production during 2003. United Taconite immediately filed a motion seeking to enforce the Order, claiming that both the Agreement and the Order specifically prohibited MDOR from using any taconite production of the Debtor in its taconite production tax assessed against United Taconite. United Taconite's position was that the production in 2001 and 2002 should be zero, and that the average should only apply to its production in 2003. It based this argument on two aspects of the Agreement and the Order. First, both the Agreement and the Order explicitly state that United was purchasing the assets free and clear of all liens claims, interests, or encumbrances. Second, both the Agreement and the Order state that United was not assuming any liabilities relating to any taconite production tax attributable to the mining of taconite by the Debtor.

After addressing jurisdiction and the taxing statutes, the Court addressed the heart of the matter, the Court analyzed whether the taconite production scheme, and its subsequent application, created an "interest" as that term is used in section 363(f) of the Bankruptcy Code. The court stated that the three year averaging formula does not effect taxation in a current year, but rather the underlying *ad valorem* real estate tax that the production tax replaces. Therefore, taconite production of a past year in the

cycle did not give rise to a property interest in favor of MDOR upon the application of an averaging formula. Furthermore, because MDOR did not assess the tax prior to the sale, no lien was created under section 270.69 of the Minnesota Statutes. The Court therefore held that MDOR did not hold or gain an "interest" in the facility arising from Debtor's past production.

Next, the Court addressed whether the Order prohibited MDOR from applying the averaging formula to historical taconite production at Debtor's facility. Reasoning that because the Order specifically referenced the taconite production tax statutes, it was clear that the terms in the Order were to be read and construed in light of the taconite production tax statutory scheme. Pursuant to that reading of the Order, the Court then determined that MDOR's apportionment of the taconite production tax did not violate the Order.

Former Shareholder Lacked Standing to Appeal Bankruptcy Court Order

In Yates v. Forker (In re: Patriot Company), Case No. 04-6007NI (B.A.P., 8th Cir. 2004), the Bankruptcy Appellate Panel for the Eighth Circuit held that a former shareholder lacked standing to appeal from an order of the Bankruptcy Court because he failed to demonstrate that there was a reasonable possibility of a surplus in the bankruptcy case after satisfying all priority and general unsecured claims. The appellant, Duane Yates, was the former president and sole shareholder of the Patriot Company. Yates was incarcerated post-petition and filed numerous objection to the Trustees' motions throughout the case. In this particular appeal, Yates objected to an order of the Bankruptcy Court granting the trustees' motion to compromise the Estate's claims against its insurance companies. In its order, the Bankruptcy Court stated that Yates failed to demonstrate that Patriot stockholders, or the holders of late filed claims, one of which Yates held, would benefit from a successful objection to the settlement. Yates appealed from the Bankruptcy Court's order.

To determine Yates' standing to appeal, the BAP employed the "person aggrieved" test which requires that the appellant show a basis for arguing that the challenged action caused him cognizable injury. This test effectively limits standing to persons with a financial stake in the Bankruptcy Court's order. In the case of a shareholder, the party must show a reasonable possibility of a surplus after satisfying all priority and general unsecured claims. The panel held that Yates failed to establish that a successful objection to the Motion of Compromise would result in a surplus to priority claimants and unsecured creditors. Therefore, the panel held that Yates did not have standing as a stockholder to object or appeal. As a result, because Yates did not have standing to appeal, the appellate panel did not have jurisdiction to rule on any issues raised by his appeal. The Court dismissed the appeal.

"Heavy Vehicle Tax" Entitled to Priority Treatment

Affirming the decision of the bankruptcy court, the Bankruptcy Appellate Panel for the Eighth Circuit recently concluded that an obligation imposed by Section 4481 of the Internal Revenue Code for vehicles over a certain weight is an excise tax entitled to priority under section 507(a)(8)(E). In determining that the tax was entitled to priority, the Bankruptcy Appellate panel found that operating a heavy vehicle falls within the broad definition of "transaction," as that term is used in section 507(a)(8)(E).

ERISA Fiduciary Held Not A "Fiduciary" under 11 USC § 523(a)(4)

In Hunter v. Philpott (In re: Philpott), Appellate Case No. 03-2788, (8th Cir., 2004.), the Eighth Circuit Court of Appeals held that a collective bargaining agreement that required the Debtor's company to make payments to several union pension funds was not an express trust and did not make the Debtor a "fiduciary" within the meaning of 11 U.S.C.§ 523 (a)(4).

The Debtor was one of the principal shareholders of Quality Homes which was party to a collective bargaining agreement that required to Quality Homes to make contributions to union pension funds based upon the employment of union members. Quality Homes failed to make contributions when required. During this period, however, Debtor and his fellow shareholder withdrew over $24,000 from Quality Homes' account. The union funds sued and Debtor filed bankruptcy. The unions then sought to have the Debtor's obligation determined to be non-dischargeable based upon § 524(a)(4) alleging that he had committed defalcation of the Funds' property while acting as a fiduciary.

The Eighth Circuit noted that the term, "fiduciary", under § 523(a)(4), refers to only trustees of "express trusts." The Collective Bargaining Agreement did not include a provision that explicitly required the Debtor's company to hold income earned on the union members labor in trust for the satisfaction of liabilities owned to the pension funds. Accordingly, the Debtor was not legally obligated to hold any particular property for the benefit of the pension funds. The Court also looked to see whether the transaction was merely a contractual relationship rather than a fiduciary one. Further, because the individual Debtor was not personally a party to the Collective Bargaining Agreement, he could not have expressly assumed the status of a trustee of any trust arising from that document. The only trust that may have resulted would have sprung from a wrongful act of the Debtor, i.e., a constructive trust. However, in the section 523 (a)(4) context, the fiduciary relationship must preexist the contested debt. Accordingly, the Eighth Circuit reversed the District Court, and remanded with direction to dismiss the Adversary Complaint.

Trustee Can Pursue A Fraudulent Transfer Action Even Though Estate Has No Remaining General Unsecured Claims

In Stalnaker v. DLC, Ltd., No. 03-3096 (8th Cir., July 22, 2004), the Eighth Circuit Court of Appeals held that a trustee may pursue a fraudulent transfer action solely for the benefit of administrative claims arising from the trustee's attorneys' fees and expenses. The trustee had filed the fraudulent transfer action at a time when recovery would have benefited unsecured creditors. After over four years of litigation, all of the unsecured claims were settled on the eve of trial of the fraudulent transfer action. The defendant moved to dismiss arguing that, since all the creditors' claims had settled, any avoidance and recovery by the trustee would not be "for the benefit of the estate" as required by Bankruptcy Code § 550(a). In upholding the bankruptcy court's denial of the dismissal motion, the Court of Appeals stated that the bankruptcy "estate" and its unsecured creditors are not synonymous. The settlement of the unsecured claims did not extinguish the bankruptcy estate, and the trustee could pursue the fraudulent transfer action for the benefit of payment of the administrative claims.

This should not be a case of "bad facts creating bad law." In its opinion, the Court of Appeals was clearly troubled by two facts: (1) the trustee had been pursuing the action for over four years, and (2) it was the defendant who effectuated settlement with

unsecured creditors on the eve of trial. The court noted its discomfort with the idea that a trustee could file and pursue an action for a significant period of time, only to have creditors' claims settled late in the game, leaving the trustee and his or her professionals uncompensated for their efforts. Administrative claims had been incurred and were in existence at the time the unsecured creditors settled. It is unlikely that the court would have reached the same result had the trustee commenced the action at a time when there were no unsecured creditors.

District Court Holds That Student Loan Debt Was Properly Discharged Despite The Debtor Having Some Ability To Repay Her Student Loan Debt.

In United States Dept. of Education v. Reynolds, 2004 WL 1745835, the United States District Court upheld a Bankruptcy Court decision which allowed a student loan debtor to discharge nearly $160,000.00 in student loans despite having $700.00 to $1,000.00 per month of disposable income.

The District Court was asked to review a decision by the Bankruptcy Court that found the Debtor qualified for an undue hardship discharge pursuant to 11 U.S.C. 523(a)(8). The Debtor had taken out approximately $142,044.55 in student loans during her educational career. The Debtor graduated from Claremont McKenna College, and earned a law degree from the University of Michigan Law School. After passing the Colorado Bar Exam on her first attempt, Debtor had difficulty finding a job related to her newly acquired law degree. The Debtor began experiencing mental health problems including major depression, panic and anxiety disorder, agoraphobia, and borderline personality disorder. Despite having these mental health problems, the Debtor was able to secure employment as secretary-receptionist where she earned $1700.00 per month. The Debtor's husband worked as a standby school bus driver, and the Bankruptcy Court found that he had had a monthly income of $1,600.00 per month. The Reynolds' combined income of $3,300.00 exceeded their monthly living expenses of approximately $2,600.00 by $700.00. There was argument from the student loan lenders that the Reynolds' had monthly disposable income in the neighborhood of $1,000.00.

The District Court followed the approach adopted in the Eight Circuit to determine whether the student loan debt was an "undue hardship" on the Debtor. The Eighth Circuit applies the totality of the circumstances or *Andrews* test, which considers the factors: (1) the debtor's past, present and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependant's reasonably necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case. The District Court noted that despite having the three factor test, there is no clear case precedent in the Eighth Circuit concerning which, if any, of the factors should predominate the court's analysis. The Court recognized a conflict in that a debtor's mental health is a factor in analyzing undue hardship, but also recognized that existing case law states that a person with the ability to pay his or her student loan should not have their student loan debt discharged.

Ultimately, the District Court affirmed the Bankruptcy Court's decision that held "[n]ondischargeability poses such negative consequences to [Debtor's] mental health recovery, that they outweigh her current ability to make payment on at least a portion of her educational loan obligations."

NEWS

News from the Court

The U.S. Bankruptcy Court is currently in the process of migrating from its locally developed Electronic Records System (ERS) to the Case Management and Electronic Case Filing (CM/ECF) program developed by the Administrative Office of the United States Courts. Conversion to the new system will occur in 2005.

Filers will notice many similarities between the two systems, including a required user name and password, data input screens, drop-down menus, pdf files, and real time filing. The Court is also incorporating some of the most popular features from ERS, such as the screen help text and "unlisted document," into CM/ECF.

CM/ECF will include some changes, including more case filing options, a judge/trustee assignment feature, automatic email notification of interested parties when there is docket activity in a case, and on-line credit card payment of filing fees. The most notable change is that CM/ECF requires users to pay for viewing and downloading information.

Court staff are currently developing and testing docket events for the new system. Internal staff training is also underway with attorney training to begin in 2005. Several training options will be offered for attorneys and their staff, and training information will be emailed to attorneys and will also be posted on the Court's web site, www.mnb.uscourts.gov as it is available. For a preview of the new electronic filing program, click "ECF 101" from the drop-down menu at CM/ECF on the Court's home page. The September 2004 *CM/ECF Update,* also found on the drop-down menu, provides more detailed information about the similarities and differences between ERS and CM/ECF.

News From the Chapter 13 Trustee's Office.

Chapter 13 Trustee's Fees will be 6.3% for the fiscal year beginning October 1, 2004.

The next Chapter 13 **brown bag lunch** will be held beginning at 11:30 a.m. on Friday, October 8, at the 2nd floor conference room in the Plymouth Building. The topic and further details will be announced after the Bankruptcy Institute.

Work continues apace on **the revised local form Chapter 13 plan**, with a subcommittee meeting scheduled for September 17.

Chapter 13 filings continue to outpace last year's total. For example, Chapter 13 filings were up 17% in Minneapolis and 21% in St. Paul for the month of July 2004, compared to July 2003. By comparison, Chapter 7 filings declined by 19% in Minneapolis and 21% in St. Paul for the same months. As a result, the Chapter 13 341 meeting calendars have been extremely full. Attorneys are encouraged to take extra steps to insure that their clients attend the first scheduled date for their 341 meetings, as it has been exceedingly difficult to find space on future calendars to reschedule missed meetings.

News From the Section President.

The next Section Meeting is scheduled for October 19, 2004. The location and other details will be coming to you shortly in the October Meeting Notice.